# IOWA UTILITIES BOARD Energy and Policy Sections

Docket Nos.: SPU-2005-0015

(RPU-2014-0001 and

TF-2014-0033)

Utility: Interstate Power and Light

Company

File Date/Due Date: March 25, 2014

Memo Date: April 29, 2014

**TO:** The Board

**FROM:** Dan Fritz – Team Lead, Venkata Bujimalla, Leslie Cleveland, Barb

Oswalt, Gary Stump, Jane Whetstone

**SUBJECT:** Proposed Settlement in Docket No. SPU-2005-0015

## I. Background

On January 13, 2014, Interstate Power and Light Company (IPL) filed with the Utilities Board (Board) a "Motion for Approval of Corporate Undertaking and Corporate Undertaking." IPL said the filing was made in compliance with the Board's January 31, 2013, order in Docket Nos. SPU-2005-0015 and TF-2012-0577, where IPL was directed to file a corporate undertaking by January 13, 2014, in the event IPL files a general rate case proceeding in the first quarter of 2014. IPL said that it was working with the parties to resolve issues related to the new purchase power agreement (PPA) with NextEra Energy Duane Arnold, LLC (NextEra), but that if those issues were not resolved, IPL was committed to removing NextEra PPA capacity costs from base tariff rates in a general rate case to be filed in 2014, with a refund obligation that begins the same day as energy adjustment clause (EAC) cost recovery for the new NextEra PPA charges starts, that is, on February 22, 2014. For administrative purposes, the filing was identified as Docket No. RPU-2014-0001. The Board approved the corporate undertaking by order issued February 19, 2014.

On February 14, 2014, IPL filed a request for approval of a proposed rate notification pursuant to 199 IAC 26.5(1)"d"(1), which requires that all nonstandard notices be approved by the Board. The proposed notice, identified as Docket No. RN-2014-0001, was approved, with some modification, by order issued March 13, 2014. The order also scheduled eight consumer comment hearings throughout IPL's service territory.

On March 25, 2014, IPL, the Consumer Advocate Division of the Department of Justice (Consumer Advocate), the Iowa Consumers Coalition (ICC), and the

State of Iowa 

Department of Commerce 

Utilities Division

Large Energy Group (LEG) filed a unanimous settlement agreement and joint motion for approval of agreement. The proposed settlement by all parties to Docket No. SPU-2005-0015 interested in the potential double recovery issue, resolves the potential double recovery of Duane Arnold Energy Center (DAEC) PPA costs raised in that docket.

The proposed settlement also contains, among other things, an electric base rate moratorium and provisions for returning certain customer credits to IPL customers. Because no electric base rate increase is being sought, the filing renders the corporate undertaking and proposed rate case notice moot. The proposed settlement is filed to comply with the Board's January 31, 2013, order in Docket No. SPU-2005-0015; because the parties reached a proposed settlement agreement, no rate case filing is necessary and Docket Nos. RPU-2014-0001 and RN-2014-0001 exist only for administrative purposes. The proposed settlement is a continuation of the primary docket, SPU-2005-0015.

In addition, IPL filed a proposed tariff, identified as TF-2014-0033, that contains a new rider and changes to IPL's EAC that would implement the customer credits agreed to in the proposed settlement. The tariff changes provide that there would be no increase in IPL's electric base rates.

On April 2, 2014, the Board issued an order docketing the tariff for investigation, requiring additional information, cancelling the consumer comment hearings, and allowing optional implementation of customer credits.

On April 9, 2014, IPL filed the additional information requested by the Board. On the same date, ICC provided information in response to additional information request number 5, which dealt with the credit to standby customers contained in the proposed settlement.

On April 22, 2014, IPL filed a response to the Board's April 2, 2014, order stating that it had conferred with all parties to the settlement and agreement was reached that IPL could begin implementation of the customer credits with the May billing cycle, beginning on or about April 28, 2014. The order provided for a true-up filing to address any subsequent modifications to the Base Rate Freeze Extension Rider (BRFER) credit factors after the Board completes its review of the settlement agreement.

#### **Summary of Settlement**

The proposed settlement would allow IPL's electric base rate moratorium to continue through 2016, subject to certain exceptions. IPL agreed not to file for an electric base increase prior to January 1, 2017, except in the case of a force majeure situation as provided for in the Board's final decision and order in Docket No. RPU-2010-0001. The other parties to the proposed settlement, Consumer Advocate, ICC, and LEG, agree not to make a filing to reduce IPL's base rates

prior to January 1, 2017, unless IPL's return on equity (ROE) exceeds 11 percent; in such an instance, the parties would have the opportunity, but not an obligation, to file a show cause proceeding for a reduction in IPL's base rates. IPL will file annual calculations of its Iowa jurisdiction ROE on or before March 31st of each year.

The proposed settlement provides that IPL's EAC and regional transmission service (RTS) cost recovery riders will continue. The other parties reserve the right to oppose one or both of these riders in a future rate proceeding. Credits passed on to customers through the Tax Benefits Rider (TBR) are to continue at least through 2016.

Finally, the proposed settlement requires IPL to provide annual calendar year rate credits to its electric customers in the following amounts: \$70 million in 2014, \$25 million in 2015, and \$10 million in 2016. Standby customers would receive \$5 million of the annual credits and the remaining credits would be applied as a credit to IPL's EAC factor pursuant to the customer class allocations contained in the proposed settlement.

The settling parties agree that the proposed settlement satisfies the commitment made by IPL to address the claim of double recovery of DAEC costs raised in Docket No. SPU-2005-0015 and the Board's January 31, 2013, final order in that docket.

# II. Legal Standards

199 IAC 7.18 provides that the Board will not approve a settlement unless it is "reasonable in light of the whole record, consistent with law, and in the public interest."

## III. Analysis

## **Revenue Requirement**

In response to the Board's request for additional information in support of the revenue requirements for 2013-2016, IPL's witness Amy Wheatley stated in her testimony that:

IPL uses projected costs and sales to forecast expected financial results. Although the forecasted financial results and the projected revenue requirement calculations are technically different measures, they produce directionally consistent results.

Along with other information, she provided a table showing changes in revenue requirements (in millions) for 2014 since the last rate case, Docket No. RPU-2010-0001.



Wheatley also stated that items related to Production Tax Credits (PTCs) and TBRs in rate base do not reflect actual increases in customer net costs, but rather reflect proposed changes in the cost recovery mechanism. She stated that IPL would likely have proposed to incorporate PTCs into the EAC. She also stated that they shared this data with the parties during settlement discussions.

IPL witness Schmidt stated in his testimony	that IPL could have justified revenue
requirement changes of	based on a 10 percent ROE
compared to the proposed settlement credit	s of (\$70M), (\$25M), and (\$10M),
respectively in 2014, 2015, and 2016. In ad	dition, IPL has provided a revenue
requirement for 2013 based on a 2012 test	year that could justify
if all the test year changes are acce	epted by the Board. Staff would note
that the original DAEC PPA was in effect for	the entire year in 2013 and a post-
test year adjustment would be necessary to	remove these costs going forward.
This would change	
This level is consistent with the project	ections provided for years 2014-2016.

IPL stated that the proposed settlement shall be null and void, unless it is approved in its entirety without condition or modification.

#### Staff Analysis

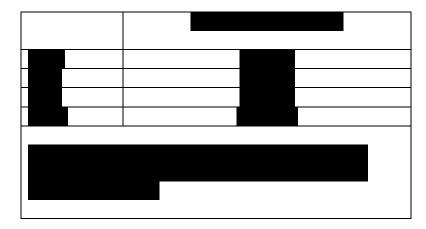
IPL's 2014 projected revenue requirement calculation includes items such as moving the impacts of PTCs and TBRs to the EAC, approval of prudency of cancelled environmental projects, a 10 percent ROE and changes in capital structure.

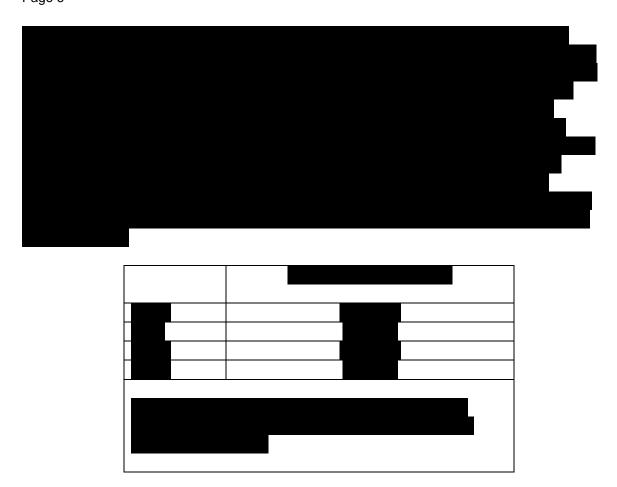
The proposed settlement agreement provides for \$70 million, \$25 million, and \$10 million, respectively as credits for 2014, 2015, and 2016 via a separate EAC

factor by class. Out of these amounts \$5 million is set aside to allocate to standby customers in each year.



Staff has calculated IPL's estimated ROE for each year 2013-2016 using the projections provided by IPL. Following are the projected ROEs for each year after the test year changes are included:





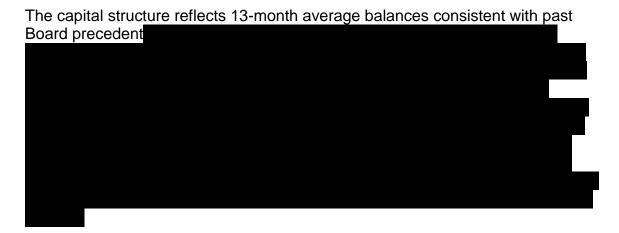
In Docket No. RPU-2013-0004, the Board required MidAmerican Energy (MidAmerican) to file updates related to the installation of environmental equipment. In addition, MidAmerican's phase-in amounts for years two and three were contingent on the equipment being installed and running prior to collections occurring. Staff believes that IPL should be required to provide updates indicating the progress on the installations and also notice when these installations are complete and in use. Since IPL is not requesting increased rates resulting from the environmental installations, staff believes that requiring semi-annual updates is sufficient.

#### **ROE/Capital Structure**

As mentioned earlier, within the proposed settlement there is a base rate moratorium through the end of 2016. These base rates reflect the capital structure established in the Board's Final Decision and Order in IPL's last electric rate case, Docket No. RPU-2010-0001. This includes a 10 percent ROE for non-ratemaking principle rate base. Without evidence in the record regarding the reasonableness of a 10 percent ROE implicit in the proposed settlement, staff refers to the two recent decisions made by the Board as support. In Iowa American Water, Docket No. RPU-2013-0002, the Board approved a 9.9 percent ROE, and in MidAmerican's electric rate case, Docket No. RPU-2013-0004, the

Board approved a settlement that included a 10 percent ROE for non-ratemaking principle rate base. IPL points out in its response to the Board's order requiring additional information that it would have requested an ROE higher than 10 percent if it had filed a rate case in lieu of the settlement. It also states that it would have expected from 2009 to 2013 associated with capital structure.

The Board ordered IPL to provide projected revenue requirements for the years the rate moratorium would be in effect including its projected capital structures. In Docket No. RPU-2010-0001, the capitalization ratios for long-term debt, preferred equity, and common equity were 45.325 percent, 6.481 percent, and 48.194 percent, respectively. If IPL would have filed a request for a rate increase in 2014, it would have filed a capital structure for the test year 2013 reflecting proforma adjustments occurring into 2014. IPL provided a 2013 capital structure.<sup>2</sup>



However, it should be noted that IPL did not apply double leverage in determining the overall rate of return in its projected capital structures. Therefore, the weighted ROE used to determine the revenue requirement would be lower. For ease, using the ROEs from the last rate case (that reflect double leverage) in place of the ROEs used by IPL,<sup>3</sup> staff determined the overall weighted rate of return would be reduced by approximately for 2013.

<sup>&</sup>lt;sup>1</sup> It is not clear how that number was determined. However, staff speculates that it is driven primarily by a higher ROE and not applying double leverage.

<sup>&</sup>lt;sup>2</sup> Confidential 2013 Exhibit (JPN-1), Schedule E in Attachment 1, page 137 reflecting several pro forma adjustments.

<sup>3</sup> For Empty plant IPI is POE of 12.23 percent uses replaced with the POE of 12.23 percent uses replaced with the POE.

<sup>&</sup>lt;sup>3</sup> For Emery plant, IPL's ROE of 12.23 percent was replaced with the ROE of 11.578 percent; for the Whispering Willow plant, IPL's ROE of 11.7 percent was replaced with the ROE of 11.092 percent; and for all other plant, IPL's ROE of 10.0 percent was replaced with a 9.531 percent ROE.

Based on staff's review of the ROE and the projected capital structures provided in the additional information filed with the Board, staff believes the proposed settlement is reasonable.

Finally, the parties agreed not to file a rate case to decrease rates before January 1, 2017, unless IPL earns above 11 percent ROE calculated using MidAmerican's methodology agreed to in Docket No. RPU-2013-0004. IPL will file annual calculations with the Board by March 31<sup>st</sup> of each year. This is similar to what the Board granted MidAmerican. MidAmerican is allowed to earn up to 11 percent ROE before any sharing of excess earnings begins. Staff believes that this is also reasonable considering the whole settlement.<sup>4</sup>

### **Proposed Base Rate Freeze Extension Credit Rider**

Article IX of the proposed settlement describes rate credits that customers will receive from 2014 through 2016, with the credits ending on December 31, 2016. The following chart shows the total amount of the credit each year and the amount applicable to each customer class.

Table 1 – Credit by Customer Class for 2014 through 2016

	Percent	2014	2015	2016
Total		\$70,000,000	\$25,000,000	\$10,000,000
Standby		\$5,000,000	\$5,000,000	\$5,000,000
Res	39.0%	\$25,350,000	\$7,800,000	\$1,950,000
GS	18.3%	\$11,895,000	\$3,660,000	\$915,000
LGS	34.5%	\$22,425,000	\$6,900,000	\$1,725,000
Bulk Power	7.0%	\$4,550,000	\$1,400,000	\$350,000
Lighting	<u>1.2%</u>	<u>\$780,000</u>	<u>\$240,000</u>	\$60,000
Subtotal	100.0%	\$65,000,000	\$20,000,000	\$5,000,000

The standby customers would receive a credit of \$5,000,000 each year with the remaining annual credit amount allocated to classes based on the percentages shown in the table above. The methodology for distributing the credits to standby customers and the remaining customers is described below.

#### Standby Customers

The credits would be directly assigned as a fixed monthly amount for each customer in the standby class taking service as of December 31, 2013. If a standby customer discontinues standby service, the customer would no longer receive the standby credits and any shortfall would be reflected in a final

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<sup>&</sup>lt;sup>4</sup> The MidAmerican case is still pending.

reconciliation of credits for the remaining standby customers. The credits to the standby customers are intended to address their concern regarding transmission charges associated with standby service. Standby customers are currently billed for transmission reservation service based on contracted kW demand levels and not their actual kW demand coincident with IPL's monthly system peak demand. The following table shows the combined annual dollar impact under both billing methods for the standby customers based on 2013 information.

Table 2 – Results of Alternative Standby Customer Transportation Reservation Charges



On April 9, 2014, ICC filed a response to the Board's April 1, 2014, order requiring additional information. ICC believes that a much higher credit would be justified but is willing to agree to the \$5,000,000 credit for settlement purposes. Ultimately, ICC requests that the Board approve the proposed settlement.

### Remaining Customers

The portion of the credit applicable to the remaining customers is allocated to the classes based on the results of IPL's preliminary cost-of-service study. The allocation factors represent the percentage of the total cost-of-service allocated to each customer class in the preliminary study. Once allocated to customer classes, the per kWh credit for each class would be calculated based on forecasted energy usage and then applied to the monthly EAC factor for each class. During the first quarter of each year, IPL would make the necessary adjustments to reconcile any over-or-under-credited amounts by class.

#### Staff Analysis

The distribution of the base rate freeze extension credit dollars to customer classes and the distribution of the credits to customers within the class appear to be reasonable. The standby rate issue is likely to be contentious in IPL's next rate proceeding. The proposed settlement appears to represent an attempt to balance the interests of the standby customers' concerns with the interests of the remaining customers by allocating a fixed dollar amount to the standby class—a

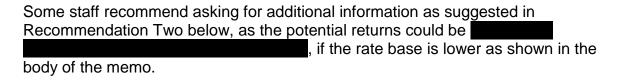
<sup>&</sup>lt;sup>5</sup> The preliminary cost-of-service study is based on calendar year 2012 data and reflects impacts of the following three factors associated with the new Duane Arnold Energy Center (DAEC) power purchase agreement (PPA) including: 1) lower purchased power costs; 2) imputing 75 percent of the costs as a capacity component which is allocated based on the average and excess allocator with the remaining 25 percent allocated based on energy; and 3) adjusting test year 2012 revenues to reflect recovery of all DAEC PPA costs through the EAC.

dollar amount that falls well below the annual difference between the two billing approaches shown in Table 2 above.

The allocation factors used to distribute the remainder of the annual credit between customer classes (excluding the standby class) are based on the results of the preliminary cost-of-service study. Although Attachment 1 (DV) Schedule A provided in response to the Board's April 2, 2014, order provides the results of the study, staff is unable to fully review the content of the study without the supporting documentation. However, the cost-of-service study contains approximately 20 allocation factors that are applied to various cost components which ultimately produce the total cost-of-service for each customer class—the basis for the allocation factors. Although any number of alternative allocation factors could have been used, allocation based on total cost-of-service appears to be reasonable.

#### IV. Overall Staff Recommendation

Staff has completed its review of the proposed settlement in Docket No. SPU-2005-0015. The proposed settlement provides benefits to customers through 2016, while at the same time including protections against higher than expected earnings. Staff believes the proposed settlement is reasonable in light of the whole record, consistent with law, and in the public interest. However, as is the case in most settlements, the information provided does not include the level of detail that a full rate case filing would provide. While staff believes that the settlement should be approved, it is important that the Board be made aware that future cost impacts could change IPL's earnings levels. Staff's calculated ROEs during the settlement period indicate that earnings will be relatively consistent and slightly above 10 percent. However, these earning levels are based solely on information included in the proposed settlement and do not account for revenues and expenses that could potentially change these results.



# **Recommendation One**

Direct the General Counsel to draft an order for the Board's consideration approving the proposed settlement in Docket No. SPU-2005-0015, (RPU-2014-0001 and TF-2014-0033) as described in the body of this memo.

RECOMMENDATION APPROVED	IOWA UTILITIES BOARD
/dwf	Date
	Date
	Date

# **Recommendation Two**

Direct the General Counsel to draft an order for the Board's consideration requiring additional information related to depreciation as described on page 6 of this memo.

RECOMMENDATION APPROVED	IOWA UTILITIES BOARD		
	/s/ Elizabeth S. Jacobs	5-2-14	
/dwf		Date	
	/s/ Nick Wagner	5/12/14	
		Date	
	/s/ Sheila K. Tipton	5-5-2014	
		Date	